

Franchise Tax Board**ANALYSIS OF ORIGINAL BILL**Author: Wolk, et al.Analyst: Deborah BarrettBill Number: SB 777Related Bills: See Legislative HistoryTelephone: 845-4301Introduced Date: February 27, 2009Attorney: Patrick Kusiak

Sponsor: _____

SUBJECT: State Budget/Performance Based Budget**SUMMARY**

This bill would require that the Governor's budget submitted to the Legislature beginning with the 2011-2012 fiscal year be developed using performance based budgeting methods for each state agency.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to provide accountability for state agency expenditures of state funds and provide objective measurements to evaluate their actions.

EFFECTIVE/OPERATIVE DATE

This bill would be effective January 1, 2010, and operative beginning with the 2011-2012 fiscal year budget.

POSITION

Pending.

ANALYSIS**FEDERAL/STATE LAW**

To formulate the federal budget, Congress must have a starting point. This is known as the baseline and is comprised of a set of projections showing the levels of spending and revenues that would occur for the upcoming fiscal year and beyond if existing programs and policies were continued unchanged. In the baseline, spending for all programs is adjusted so that existing levels of activity are maintained. With respect to certain types of federal programs, the baseline adjusts for, among other things, the effects of inflation and demographic changes that alter the expected number of beneficiaries. In considering proposed levels of spending and revenues, members of Congress usually describe the cost of their proposals as being above, below, or equal to the baseline.

Board Position:

_____ S	_____ NA	_____ NP
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_____ N	_____ OUA	_____ <u>X</u> PENDING

Department Director

Date

Selvi Stanislaus

04/15/09

State law requires the Department of Finance (DOF) to develop, issue, and implement consistent and adequate guidelines for state agencies to follow when submitting budgets. The guidelines must ensure the following:

- The budgets are reflective of an agency's activities;
- The budgets are reflective of the costs that are associated with their execution; and
- The budgetary presentation is designed to display expenditures based on various goals or objectives when a program budget format is used.

DOF, in cooperation with the Legislature, must develop a format for state agencies to use when developing a program budget.

Every state agency and court that receives an appropriation is required to submit a complete and detailed budget to DOF. The budget must be in the form DOF prescribes and must include all proposed expenditures and estimated revenues.

Generally, every state agency reviews their expenditure plans and prepares an annual baseline budget to maintain existing service levels. In addition, they may prepare Budget Change Proposals (BCPs) to adjust service levels. DOF analyzes the baseline budget and BCPs, estimates revenues, and prepares a balanced expenditure plan for the Governor's approval. The Governor may require state agencies, officers, or employees to furnish whatever information is deemed necessary to prepare the budget. The Governor's Budget is submitted to the Legislature by January 10th of each year. The Governor and Legislature are required to enact a budget package by June 15th of each year. After enactment, the state agencies administer, manage change, and exercise oversight of the Budget on an ongoing basis. In addition, the Joint Legislative Budget Committee is involved in the ongoing administration of the Budget and reviews various requests for changes to the Budget.

See Appendix A for a general explanation of the different types of budgeting and their uses in California.

THIS BILL

This bill would require the annual budget set forth by each state agency to the DOF to utilize performance-based budgeting methods that identify or update all of the following:

- The mission of the agency or judicial branch.
- The goals established to accomplish the mission.
- The activities developed to achieve state goals.
- The performance goal and an outcome-oriented performance measure for each activity for which an appropriation is made or requested.
- A cost per unit of services for the performance results achieved from each activity as calculated using activity-based costing or an equivalent managerial cost accounting approach that reflects both direct and indirect expenses incurred for each state activity.
- A justification of why the performance impact of each activity is not duplicative of activities conducted by other federal, state, or local government agencies.

- Legislatively approved output and performance standards to measure progress toward program objectives.
- Each performance measure must identify the associated activity contributing to it.
- Prior year performance data on approved performance measures and an explanation of deviations from expected performance.
- Proposed performance incentives and disincentives.

A performance-based budgeting method promotes accountability by achieving measurable performance results from the expenditure of state resources.

This bill would also require that for the 2011-2012 fiscal year and each year following, the budget that the Governor submits to the Legislature be developed by utilizing performance-based budgeting methods. The amount of each appropriation made in the Budget Act for expenditures by any state agency would be determined by each budgetary unit utilizing performance-based budgeting methods. The Budget Act also is required to include performance standards which would be proposed by the Governor and may be amended by the Legislature that would be applied to each state agency including a method for evaluating whether those standards are met to ascertain the effectiveness or efficiency of the state agency.

The bill would require the annual report prepared by the Joint Legislative Budget Committee that documents the measurements of each state agency under its respective performance-based budgeting standards to be submitted to DOF for use in making proposed adjustments to the budget for the succeeding fiscal year.

The bill would require a task force consisting of the Director of Finance, the Controller, and the Chairperson of the Joint Legislative Budget Committee to do the following:

- Develop guidelines and procedures to be used by state agencies in developing performance-based budgets for the 2011-2012 and following fiscal years, including procedures for implementing activity-based costing or other managerial cost accounting systems in each state agency.
- Develop a training and education program for appropriate budget personnel to facilitate the development of performance-based budgeting methods by state agencies

The bill would define “budgetary unit” to mean the smallest significant operational unit within a state agency that has programmatic responsibilities, including local assistance programs and authority distinct from other units at the same level in the entity’s organizational structure and that does not have subdivision or other units under it that have policy or administrative authority with respect to programmatic responsibilities.

The bill would define “state agency” to mean any agency, department, or other entity of the state, including a court that is required to submit a budget.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

Implementing this bill would have a significant impact to the department. Franchise Tax Board (FTB) currently uses the California State Accounting and Reporting System (CALSTARS) for external state level reporting. In addition, the department currently uses Activity Based Costing (ABC) as an internal management tool. ABC is a method of deriving the costs of products and services by calculating the cost of each component activity in the processes that produce and deliver these products and services. However, neither CALSTARS nor ABC currently has the capacity to establish and maintain a performance-based budget that includes the development and evaluation of performance measures and standards. As a result, this bill would require changes in the department's existing budget and revenue reporting methodology and would require retraining of existing budget staff.

The bill uses language on page 2, line 15, "The activities developed to achieve state goals." It is unclear whether the author means the goals of the State of California or whether the author intends the agency or department goals. Clarification would assist in the implementation of this bill's provisions.

This bill uses terms that are undefined, i.e., "unit of service." The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this provision.

In addition, implementation of performance-based budgeting by the department would be contingent on information that would be supplied to the department by the task force established by this bill. The department normally begins its budget process for the following fiscal year in the fall of the current year (fall 2009 for the 2010/2011 fiscal year budget). To prepare an effective performance based budget for the 2011/2012 fiscal year, the task force would need to provide the guidelines, procedures, and training outlined in this bill by fall of 2010.

TECHNICAL CONSIDERATION

Government Code section 13335.5, which is added by this bill, lacks a subdivision (d). The bill reflects subdivision (c) on page 3, line 14, then reflects subdivision (e) on page 3, line 26, skipping a subdivision (d).

LEGISLATIVE HISTORY

AB 1382 (Niello, 2009) would require that the Governor's budget submitted to the Legislature beginning with the 2011-2012 fiscal year be developed using performance based budgeting methods for each state agency. This bill was introduced February 27, 2009, and has not been heard in committee.

AB 836 (Huff, 2005/2006) would have required budgets submitted by state agencies and courts to use a zero-based budget method. This bill was referred to the Assembly Committee on the Budget but was never heard.

SB 985 (McClintock, 2003/2004) would have required budgets submitted by state agencies and courts to be developed using zero-based and performance-based budget methods beginning with the 2004/2005 fiscal year. This bill was held in the Senate Appropriations Committee.

PROGRAM BACKGROUND

In the fall of each year, the department begins the following years' fiscal budget process with a base budget that is either augmented or reduced based on changes in workloads, technology enhancements, or directives from the Legislature or Administration. The department generally uses a combination of line-item and program budgeting, as defined in Appendix A. In developing the budget, the department uses a decentralized budget management structure, which requires involvement of all organizations, programs, and projects within the FTB.

OTHER STATES' INFORMATION

According to a report published by the National Association of State Budget Officers¹, states use a combination of approaches to develop the budget, including incremental, program budgeting, zero-based or modified zero-based budgeting, and performance budgeting. The most frequently used budget approach is program budgeting with 43 states indicating that this is an approach they use. After program budgeting, incremental budgeting is the most frequent approach. Many of the approaches, such as performance budgeting, are done in conjunction with other approaches, such as program or incremental budgeting. Twenty-five states² have incorporated performance-based budgeting into their budget practices.

FISCAL IMPACT

Formulating a performance-based budget would require significant changes to the existing internal and external reports. The department would be required to capture additional information and would require a format not currently used by the department. Therefore, the existing systems would need modification, or a new program or all-inclusive system may need to be acquired. In addition, resources would be needed for training staff.

The impact of this bill on the department is unknown at this time, but could be costly for the department to implement due to possible systems and reporting changes. Ultimately, the potential departmental impact for the implementation of performance-based budgeting would depend on the outcome of the proposed guidelines and procedures to be developed by the task force discussed in this bill.

¹ *Budget Processes in the States, 2008*

² Alaska, Florida, Georgia, Hawaii, Indiana, Iowa, Louisiana, Maryland, Michigan, Minnesota, Missouri, Montana, Nebraska, New Hampshire, New Mexico, North Carolina, Oklahoma, Oregon, South Carolina, Texas, Vermont, Virginia, Washington, Wisconsin, Wyoming

ECONOMIC IMPACT

The provisions of this bill would not impact state income tax revenues.

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Appendix A

The following is a general description of the four basic types of budgeting and how California uses aspects of all the styles.

Line-Item Budgeting

The budget is prepared along departmental or programmatic lines and focuses on what is to be purchased with funds. Generally, the budget provides a separate line-item appropriation for each major category of expenditure, such as personnel services costs, operating costs, and in some cases, travel or equipment. This is the most widely accepted and best-understood technique, but does not necessarily reflect programs or services nor does it reflect performance. It is a reflection of costs to operate an agency and is as much an accounting document as it is a budget.

Uses in California: Governor's Budget (Budget Change Proposals (BCP's), Salaries and Wages Supplement, Summary by Object, Changes in Authorized Positions, Supplementary Schedules of OE&E), Budget Administration (position control, merit salary adjustment, Travel out-of-state, etc.), and Change Book (includes line-item data).

Program Budgeting

A program budget focuses on results of discrete programs and if the program achieved the expected results. An agency defines its functions or programs and applies goals, objectives, and strategies to measure performance. This process focuses on what an agency does and why, as opposed to how it does it. The emphasis is on program performance and ultimate outcomes, as opposed to inputs and processes.

Uses in California: Budget Bill, Governor's Budget (BCP's, Summary of Program Requirements, Program Objectives Statement, Program Detail), and Change Book (includes line-item data).

Zero-Based Budgeting (ZBB)

ZBB is a process designed to analyze an agency, program, or department to determine its worth and value to the government and its citizens. ZBB can take many forms, but in its purest form, this process assumes the agency does not exist and builds its programs, operations, and budget from zero to its optimum level. The agency is forced to rank their organizational purposes and programs with a focus on the priorities of and alternatives to the entity's operations.

Uses in California: Used selectively.

Performance Budgeting

A performance budget lists what each administrative unit is trying to accomplish, the planning, and the resources. It reports on how well it did with the prior year's resources. Similar to program budgeting, the emphasis is on getting the most service for the dollar. Unlike program budgeting, the emphasis is on outputs and outcomes as opposed to mission statements, goals, and objectives. It is a system that promotes accountability.

Uses in California: Governor's Budget and measures and outputs in BCP's.